No. 627

In the Supreme Court of the United States

OCTOBER TERM, 1956

GRANT E. HAYES,
Petitioner,
vs.
UNITED STATES OF AMERICA,

RONALD J. McDONALD,
Petitioner,
vs.
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REPLY TO BRIEF IN OPPOSITION

The brief of the United States in opposition to the petition for a writ of certiorari has brought up new matters of significance not adequately treated in the petition and this reply is submitted pursuant to the provisions of Rule 24(4) of the Supreme Court Rules.

1. On page 12 of its Brief the Government makes the flat statement that the petitioners' argument to the effect that the use of the new filed return as evidence against it was rejected

by this Court in the case of United States v. Sullivan, 274 U. S. 259. This is not true. The Sullivan case did not in any way pass upon the matter here presented. In the Sullivan case, the defendant was accused of failure to file an income tax return. He defended it upon the grounds that had he filed the return, the return would have revealed the fact that he was engaged in illicit traffic in liquor, and the Court held that this was not a defense to the failure to file a return. The facts in that case are not at all comparable to the case before this court. The petitioners in this case did file a return as the law required. They are now objecting to the use of that return, which they were compelled to file, as evidence against themselves. Had the defendant in the Sullivan case actually filed his return and then been charged with violation of the Volstead Act and his income tax return used as evidence against him, the Sullivan case might be near to our case on its facts.

It is our contention that Congress, by the provision which it put into Section 305 of the Excess Profits Act of 1950 intended to avoid a situation where the taxpayer would be compelled to make a refiled return and then have such return used in evidence against him when charged with making false statements in his original return.

2. At the bottom of page 13 of its Brief, the government maintains that the trial judge did not discuss the theory of the evidence of the prosecution while declining to so discuss the evidence and the theories of the defense. This matter can best be resolved by the court itself by a reading of the court's instructions contained on page 193 of the printed record in the Circuit Court.

3. The fourth question presented in the Petition (Pet. 3) and considered therein (Pet. 18, 19) was changed by the

government in its brief to the question of "whether the evidence was sufficient to support the verdict" (Br. 2), which is an entirely different question than that actually presented by the petitioners, namely, whether or not on a second appeal the Court of Appeals could totally disregard any substantial new evidence received at the second trial and refuse to consider the question of sufficiency of the evidence.

The petitioners had no thought that this court would consider the sufficiency of the evidence in connection with their petition for a Writ of Certiorari, but since the government has raised the question in its brief, and more particularly because it has a direct bearing upon the question as to whether there was substantial new and additional evidence in the second trial which should have been considered by the appellate court, the inadequacies and inaccuracies of the government's statement of the case can hardly go unanswered.

The petitioners' contention that the Court of Appeals erred in failing to review the question of the sufficiency of the evidence in view of the new evidence presented was disposed of by the government by asserting that the "alleged new evidence does not appear therein" (Br. 14). Petitioners' Statement of the Case identifies the exhibits received as new evidence in the second trial (Pet. 8) and the nature and importance of such evidence will appear more fully in the discussion that follows.

In considering the fourth question, the government's brief also states that the summary of the evidence set out in its brief (pp 5-10) "amply supports the verdicts of guilty" (Br. 14). That might be true if this alleged summary were both accurate and complete, but it is neither, for the government's summary contains some very material misstatements and omis-

sions of fact. Similar misstatements appeared in the government's briefs filed in the Court of Appeals upon both appeals. (Pet. 9).

On the surface one of the most damaging bits of evidence was proof that eleven checks written by McDonald[1] were erroneously entered on the check stubs by him as having been issued for the purchase price of parts and accessories (T. 109, 124, 209) (Br. 6, 7). When so entered, these entries on the check stubs were transferred to the book inventory of parts and accessories (T. 153). The brief in opposition mentions these facts (Br. 6, 7). Then, to put the stamp of fraud upon them, the brief states that "these amounts were deducted on the company income tax returns as parts and accessories expense" (Br. 7). If this were true it would, of course, be clear evidence of willful tax evasion, but the simple, mathematical truth, as shown by the evidence, is that these amounts were never taken as deductions for parts and accessories expense on the tax returns. The deductions for such expenses that were taken on the tax returns were computed by *taking a percentage* (based upon experience and periodic tests) *of the actual sales of parts and accessories made* (T. 149, 242). The special agent, advised of this, made no attempt to check the accuracy of the percentages used (T. 125). Neither the parts inventory as shown on the books, which was increased by entries from the eleven checks, nor checks actually written for the purchase of parts were ever used to compute the deductions taken. It is a simple, mathematical fact that the corporate income would have been no different than as reported, regardless of whether these eleven checks had either never been written or actually

(1) Ten went to Hayes and one was used to transfer funds from the First Security Bank to the Continental Bank account of the Grant E. Hayes Co.

had been issued for the purchase of parts. The erroneous entries on the check stubs made by McDonald only increased the book inventory. That is all it did and that is all it was intended by McDonald to do (T. 150). On October 1, 1946, the book inventory was only $7,150.00, far below what McDonald knew it to be from actual observation of parts on the shelves (T. 127, 148). In an effort to get the book inventory of parts back into more keeping with what he believed it to be, McDonald padded the book figures in the manner indicated (T. 148), but it didn't reduce taxable income and the government's contention that it did is erroneous. The same situation prevails with respect to the three checks of $500, $645, and $425, mentioned on page 7 of the brief in opposition.

Petitioner's exhibits A, B, C and D (T. 241, 242) consisting of records showing how the costs of parts sold were computed, and which support the above facts, were a part of the new evidence received upon the second trial which was not considered on the first appeal.

After pointing out that Studebaker Corporation discount checks and Pacific Finance Company repossession loss reserve checks were deposited in the Continental Bank account of the Grant E. Hayes Company (one went to Hayes' personal account) (Br. 6, 7, 8) the government's brief then states that "although a firm of accountants headed by J. N. Casella, C.P.A., prepared each of the income tax returns for Hayes and the Grant E. Hayes Company (R. 82) Casella's firm was not told about the Continental Bank account . . ." (Br. 8).

This also is not true. Each year a trial balance was sent to the Casella firm for the preparation of the corporate income tax return[1]. Each year the first item listed on the first

(1) The trial balances were placed in evidence by the government itself (T. 238).

page of each of the said trial balances was the Continental Bank account (T. 238). Each year page 2 of the general ledger reflected the existence of this account (T. 241). The company books were used in the preparation of the returns (T. 226). In fact, the Casella firm itself set up the corporate books in 1945 and included a record of and for the Continental Bank account in doing so (T. 145-6). But the government, with reckless abandon, alleges the account was secret and places the stamp of fraud upon the alleged secrecy.

The government's brief points out that seven $300 payments made to the Continental Bank on a personal loan of Mr. Hayes "were charged to rent," and that these "expenditures were taken as deductions on the company returns" (Br. 7). No mention is made that these seven payments were legitimate rental expenses paid to Hayes for use by the company of a used car lot purchased and owned by Hayes (T. 147). To further stamp these rental checks, and the three checks of $500, $645, and $425 mentioned above, with fraud, the government erroneously states that these checks were drawn on the so-called "secret" account in the Continental Bank (Br. 8). This, too, is not so, as these checks were all drawn on the First Security Bank account, the check stubs of which were furnished to the government by petitioners and introduced into evidence as government's Exhibit 1 (T. 209).

The government states that of three checks received from the Studebaker Corporation totaling $31,690.47, $19,313.34[1] was reported and $12,377.13 was unreported (Br. 6). This is

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(1) Government's Exhibit 71 (Tr. 240) was placed into evidence upon petitioners' insistence under the best evidence rule (T. 106) and shows how the reported income was accumulated. This evidence was not considered by the Court of Appeals on the first appeal.

true. The unreported income, together with seven volume discount checks totaling approximately $8,000.00 (Br. 6), the unreported receipts from the Pacific Finance Corporation (Br. 7) (actual amount is $8,399.19) and the $4,272.39 accumulated in the delivery and handling account (Br. 8), all represent unreported income of the corporation. The government's brief mentions each of these items, but it failed to mention the fact that checks totaling $20,385.39 drawn on the Continental Bank account (T. 212-214) constituted deductible expenses which were not claimed on the corporate income tax returns but which offset a substantial part of this unreported income (T. 130, 182). A failure to report income used to pay unclaimed deductible expenses hardly smacks of willful tax evasion.

Unreported corporate income from the Pacific Finance Corporation is mentioned (Br. 7) as evidence of fraud, but no mention is made in the brief in opposition that the same erroneous bookkeeping methods used by McDonald to accumulate reserves from this company on the books that led to this omission also resulted in an *overstatement* of corporate income from this company in the first fiscal year involved (T. 107, 117.[1] The government ignores this overstatement of income one year but shouts fraud at the understatement the next. Unreported income resulting from erroneous bookkeeping methods, unaccompanied by tax evasion motives, should not be the basis for criminal liabilities.

The brief of the government states that checks payable

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(1) Government's Exhibit 72 (T. 241) placed in evidence as part of the records insisted on by petitioners under the best evidence rule (T. 94 et seq), are records proving this fact, and were not considered by the Court of Appeals on the first appeal.

to McDonald from the Continental Bank account were not reported on his income tax returns (Br. 9). But no mention is made of the fact that the sums so paid were given to reimburse McDonald for out-of-pocket expenses incurred on behalf of the Hayes Company and as such were not income to him (T. 142, 143, 170); or that they were all deposited in his personal bank account by deposit slips that reflected that the deposits were Grant E. Hayes Company checks drawn on the Continental Bank account (T. 231). No mention is made by the government that for the year 1948, even assuming the expense checks were income, the evidence established an unreported income of only $39.40, instead of $3,956.40 as alleged (T. 114, 132, 133).

The government stresses the fact that Hayes "did not ever examine his annual income tax returns" (Br. 10). In doing so it fails to point out that a firm of C.P.A.'s had prepared his returns for many years and he had the greatest confidence in them (T. 172).

New evidence not presented at the first trial disclosed that these two men, whom the government alleges were willfully evading taxes, brought on the investigation by filing a $75.50 claim for refund (Ex. O, T. 245), then signed a consent for assessing the taxes (Ex. P, T. 245) to give the agent more time for making his investigation (T. 142). The investigation began before the 1950 returns were filed (T. 134), and, at the request of Mr. Hayes, the year 1950 was included in the investigation (T. 184, 185). The year 1950 was included in the indictment. No mention was made by the government of such facts.

The misstatements and omissions of such important evidentiary matters by the government compelled the submission

of this reply. Similar misstatements of fact by the government in its briefs have plagued petitioners on both appeals in the Court below. They should not do so here.

CONCLUSION

The petitioners again urge that there are substantial questions raised in the Petition for Certiorari that require the granting of the Writ and review of the case by this court.

Respectfully submitted,

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PROOF OF SERVICE

We, ZAR E. HAYES and BRYANT H. CROFT of counsel of record for petitioners and members of the bar of the Supreme Court of the United States, hereby certify that on the ..... day of January, 1957, we served on behalf of appellants herein, copies of the foregoing reply on the United States by leaving a copy thereof at the office of A. Pratt Kesler, United States Attorney for the District of Utah at Room 200 Federal Building, Salt Lake City, Utah, and by mailing three copies in a duly addressed envelope with air mail postage prepaid to the Solicitor General, Department of Justice, Washington 25, D. C.

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